laws prohibiting such a business, could not be made the basis of a prosecution. The Court there held that the Act imposing the so-called excise tax merely imposed it as a penalty for violation of the State laws, and that as such the Act was beyond the limits of Federal power. In affirming the judgment of the Circuit Court of Appeals, which reversed the judgment of the trial court upholding a judgment of conviction by the trial Court, this Honorable Court said:

> "We think the suggestion has never been made—certainly never entertained by this Court—that the United States may impose cumulative penalties above and beyond those specified by state law for infractions of the State's Criminal Code by its own citizens."

The Court concluded its opinion as follows:

> "In view of what has been said we do not consider the contention that the law is bad for want of the uniformity of operation required by article 1, Sec. 8, of the Constitution."

The opinion of the Circuit Court of Appeals in that case used the following language on the applicability of the uniformity requirement, should the measure in question be construed as an excise tax:

> "Significant, too, is its ambulatory character, applying not by application in particular localities of a rule geographically uniform, but by its own terms now here, now there, in this or that state, this or that locality according to state laws or local conditions. * * * When, in addition to all of this, the doubtful constitutionality of the section for want of geographical uniformity, if construed as a taxing act, is considered, we think assurance is made doubly sure that it should not be so construed."

In addition to the decisions of this Honorable Court in the three cases hereinabove discussed, dealing with the relation of Federal legislation to matters of purely State or local concern, attention is directed to the case of *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, dealing with the first Frazier-Lemke Bankruptcy Act, relating to the institution of bankruptcy proceedings by farmers. This case will be discussed hereafter under Point E, dealing with the application of the Fifth Amendment.

At this juncture we proceed with argument under Point B, dealing with the application of the Tenth Amendment.

POINT B.

Invasion of State's Rights Reserved Under Tenth Amendment.

We have set out in the petition for certiorari a reference to the constitutional and statutory provisions of the State of Texas, relating to the powers and obligations of irrigation and water improvement districts. The appendix to this brief will set forth the controlling provisions for convenient reference. At present we merely direct attention to the fact that the Texas Constitution and the Texas statutes expressly provide for the organization of such districts, the issuance of bonds by them, and the levy and assessment of taxes "to pay the interest thereon and provide a sinking fund for the redemption thereof." (Texas Constitution, Sec. 52, Article 3; Sec. 59a, Article XVI: Revised Civil Statutes of Texas, 1925, Articles 7622-7807 "Water Improvement Districts": Revised Civil Statutes of Texas, 1911, Articles 5012-5107, "Irrigation Districts"; Opinion of United States District Court at page 115 of the record.)

The Supreme Court of Texas has expressly upheld the power of such districts to levy and collect taxes. *Texas Pacific Railway Company* v. *Ward County Irrigation Dis-*

trict No. One, 112 Texas 593. It has also recognized that such districts are governmental agencies engaged in the performance of a public purpose. *Parker* v. *El Paso Water Improvement District No. One,* 116 Texas 631, citing *Fallbrook Irrigation District* v. *Bradley,* 164 U. S. 112. It has also denied a writ of error in a decision by a Texas Court of Civil Appeals upholding the validity of a tax levied by the Irrigation District for the purpose of paying its bonds wherein that court said:

> "It will be observed from what we have said that these taxes are in no sense local or special, based on special benefits received by the property taxed, but are general and *ad valorem,* levied by a public corporation to pay bonds that have been lawfully issued and validated by a decree of a court of competent jurisdiction." *Hester and Roberts* v. *Donna Irrigation District, Hidalgo County No.* 1, 239 S. W. 992.

The Texas statutes provide that all bonds of such districts shall be validated by a decree of court before issuance. Articles 7703-7706.

The Supreme Court of Texas has recognized that the rights of a bondholder include the right to compel collection of taxes by the municipality issuing the bonds. *Voorhies* v. *City of Houston,* 70 Texas 331. The Federal Courts recognize the same rule. *Hidalgo County et al.* v. *Morey,* 74 F. (2d) 101. (See also *Von Hoffman* v. *City of Quincy,* 4 Wallace 535.)

The tax being sanctioned by the State, and provision therefor being required as a prerequisite to the issuance of the bonds, and the bonds being issued for the performance of a public purpose by a governmental agency of the State, neither the State nor the Federal Government can interfere therewith; the State, because it cannot impair the obligation of contracts, and the Federal Government, because it cannot impair the sovereignty of the State.

Bondholders have a right to rely on the performance of such obligations. *Rorick* v. *Commissioners of Everglades Drainage District*, 57 F. (2d) 1048; *Meriwether* v. *Garrett*, 102 U. S. 472.

This Honorable Court has recognized that the Federal Government cannot in the exercise of any delegated power, interfere with the control of the States over their fiscal affairs. In *Lane County* v. *Oregon*, 7 Wallace 71, the Court held that a State statute requiring payment of county taxes in gold or silver coin would prevail over a Federal statute purporting to make notes of the United States legal tender and said:

> "If, therefore, the condition of any State, in the judgment of its legislature, requires the collection of taxes in kind, that is to say, by the delivery to the proper officers of a certain proportion of products, or in gold and silver bullion, or in gold and silver coin, it is not easy to see upon what principle the national legislature can interfere with the exercise, to that end, of this power, original in the States, and *never as yet surrendered.*"

The Court further said that the power of taxation "is an essential function of the Government."

If the Federal Government in the exercise of its power to control the currency cannot interfere with State fiscal affairs, how much less should it be able to do so through permitting or inviting political subdivisions of the State to invoke bankruptcy powers of the Federal Government.

This Honorable Court has recognized that irrigation, drainage, and related projects are all governmental functions of the States wherein they are exercised. *Fallbrook Irrigation District* v. *Bradley*, 164 U. S. 112; *O'Neill* v. *Leamer*, 239 U. S. 244; *Houck* v. *Little River Drainage District*, 239 U. S. 254.

The maintenance of the faith and credit of the State involves the maintenance of the faith and credit of its political subdivisions. *Anderson County Road District No. Eight* v. *Pollard*, 116 Texas 547; *Tom Green County* v. *Moody, Attorney General*, 116 Texas 299 (citing the decisions of this Honorable Court mentioned in the preceding paragraph); *Robbins* v. *Limestone County*, 114 Texas 356.

The power to "lay and collect taxes" under the Federal Constitution is embraced in the same section as the power to pass "uniform laws on the subject of bankruptcies throughout the United States" (Section VIII, Article I). It has long been recognized that this power of taxation cannot be exercised in a manner that invades State sovereignty. *Buffington* v. *Day*, 11 Wallace 113; *Pollock* v. *Farmers Loan & Trust Company*, 157 U. S. 429, 158 U. S. 601.

The law under consideration in the *Pollock* case provided "that nothing herein contained shall apply to States, counties, or municipalities." This is similar to a clause in the Municipal Bankruptcy Act about not interfering with State control of political subdivisions. Nevertheless the Court held that a tax on the income of municipal bonds would constitute an invasion of State sovereignty, and could not be sustained, pointing out that it would interfere with the State's "power to borrow * * * and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the Constitution."

Article 7712, Revised Civil Statutes, 1925 (Texas) expressly provides that the directors of such a district "shall levy a tax upon all property within such District sufficient in amount to pay the interest on such bonds, together with an additional amount to be placed in the sinking fund, suf-

ficient to discharge and redeem said bonds at their maturity." As said in the case of *Meriwether* v. *Garrett, supra,* the levying of taxes "is a high act of sovereignty * * * When a tax has been authorized by law to meet them (obligations), it has compelled the officers of assessment to proceed and levy the tax, and the officers of collection to proceed and collect it, and apply the proceeds. In some instances, where the tax was the inducement and consideration of the contract, all attempts at its repeal have been held invalid."

Even in the case of *Willcuts, Collector* v. *Bunn,* 282 U. S. 216, in which an income tax on the profit derived from the sale of municipal bonds was upheld, the Court pointed out that no Federal tax could be upheld against the bonds themselves, or the income derived therefrom in the form of interest, saying:

> "And a tax upon the obligations of a State or of its political subdivisions falls within the constitutional prohibition *as a tax upon the exercise of the borrowing power of the State.*"

The constitutional and statutory provisions in Texas amounted to a pledge of the faith and credit of the District for the payment of the bonds, which in effect, pledges the resources of the District. See *Rorick* v. *Commissioners of Everglades Drainage District, supra,* dealing with a similar Florida district; and *Village of Kent* v. *United States,* 113 Fed. 232.

It cannot be successfully contended that the bonds issued and the taxes authorized to be levied for their payment were not acts of sovereignty in performance of governmental duties and the exercise of governmental capacities. *United States* v. *Railroad Company,* 17 Wallace 322. That case involved bonds issued by the City of Baltimore

under authority from the State, and it was held that the income therefrom could not be taxed, the Court saying:

> "The action is no less a portion of the sovereign authority, when it is done through the agency of a town or city corporation."

The Internal Revenue Act there under consideration, like the present Municipal Bankruptcy Act, attempted to protect against the charge of unconstitutionality by providing that it was not the intent to affect such corporations "in the exercise only of functions strictly belonging to them in their ordinary governmental and municipal capacity". The bonds there were issued for the purpose of aiding in the construction of a railroad entering the City.

Certainly bonds issued for the purpose of enabling the District to perform the only governmental function it was organized to perform, to-wit: irrigation, cannot be considered as issued in a proprietary instead of a governmental capacity.

The mere declaration in Section 80 (k) of the Municipal Bankruptcy Act that "nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any political subdivision thereof in the exercise of its political or governmental powers" cannot save that Act from the charge of unconstitutionality, because the Act seeks to reach such political subdivision, not only when the State consents, but also when the State has not exercised its power "to require the approval by any governmental agency of the State of the filing of any petition," or has no existing fiscal agency whose affirmative approval is required under the terms of the Act.

The Circuit Court of Appeals seems to rest its opinion entirely upon the effect of Section 80 (k) above mentioned. It incidentally refers to the fact that while a sovereign

State may not be sued without its consent, it may invoke the jurisdiction of the Federal Court. Obviously the action of a State in subjecting itself to the jurisdiction of the Federal Court, does not change or alter its sovereign rights. The State can no more impair its obligations through action in the Federal Court, than it can through action in the State Court. The protection of the Constitution, both national and State, surrounds both forms. The State can waive venue or jurisdiction, and appear in the Federal Court, but cannot thereby submit itself to the application of a Federal Act which has no power otherwise to reach it. As pointed out in the case of *Clark* v. *Barnard*, 108 U. S. 447:

> "The immunity from suit belonging to a State * * * is a personal privilege which it may waive at pleasure."

The Circuit Court of Appeals apparently attempts to draw a distinction between a State, and its political subdivisions, citing cases to the effect that counties and municipalities are suable in the Federal Court despite the adoption of the Eleventh Amendment to the Federal Constitution. The three cases cited to that effect all base the conclusion announced upon the fact that in each of the states involved therein, state legislation had authorized such political subdivisions to enter into contracts, and to be sued thereon in the courts of the state. Having the power to contract, and being suable, this Honorable Court merely concluded in those cases that the Federal Courts could exercise jurisdiction likewise, and that the Eleventh Amendment did not prohibit the exercise of this jurisdiction, because it was confined expressly in its application to forbidding suits against any "one of the United States."

But for the Eleventh Amendment states would also be suable. The mere fact that the amendment does not pro-

hibit suits against counties and other political subdivisions does not change their nature or characteristics.

No distinction has been drawn between the powers of the Federal Government in levying taxes against state bonds, or bonds issued by political subdivisions of a State. *Pollock* v. *Farmers Loan & Trust Company, supra; United States* v. *B. & Q. Railroad Company, supra.*

The opinion of the Circuit Court of Appeals really recognizes that there is no valid distinction between the state and its political subdivisions, with reference to the application of the Municipal Bankruptcy Act, except for the language of Section 80 (k) heretofore mentioned. The court says:

> "It is apparent that the Act of May 24, 1934, was not intended to interfere with the *sovereign rights of any State.* Full control over the *liquidation of the indebtedness of any political subdivision is reserved to the state* under the provision of Section 80 (k) above quoted. If the state chooses to exercise her sovereign authority, she has the right to do so and the Act is without effect."

If this is true then the application of the Act to political subdivisions *depends upon a waiver of State sovereignty, which cannot be waived except by constitutional amendment delegating power to the Federal Government.*

Only by such a constitutional amendment, making the law applicable to all of the states of the Union, could the Municipal Bankruptcy Act be made uniform throughout the United States. This leads to Point C.

POINT C.

Lack of Geographical Uniformity in the Application of the Municipal Bankruptcy Act.

Section 80 (k) of the Act reflects that it does not purport to apply to political subdivisions of states which have established fiscal agencies exercising authority over such

subdivisions, unless such fiscal agency consents to the filing of the petition; and further that the Act does not purport to apply to political subdivisions of states which pass legislation requiring the approval by any agency of the state of the filing of any petition, unless such approval is obtained. In other words, as is said by the Circuit Court of Appeals:

> "If the State chooses to exercise her sovereign authority she has the right to do so, and the Act is without effect."

This being true, the Act depends for its application not upon the will of Congress, but upon the will of the Legislature of each State.

It is difficult to imagine that a bankruptcy law would be upheld as uniform, should it provide that its only application was to citizens of states which had consented for its citizens to invoke the national act.

In the case of *International Shoe Company* v. *Pinkus*, 278 U. S. 261, this Honorable Court held an Arkansas statute, dealing with insolvents, to be unconstitutional because it invaded the field occupied by the National Bankruptcy Act. In that case the Court said:

> "*The national purpose to establish uniformity necessarily excludes state regulation.* * * * States may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulation."

Of course, State exemption laws may be and are recognized by the National Bankruptcy Act; but those State laws do not remove the insolvent from the jurisdiction of the bankruptcy court, and they give to the creditor whatever he could reach by execution under the State laws. Furthermore, such exemption laws of the State cannot be

given retroactive effect, even by national legislation, so as to impair the obligation of contracts, under the guise of bankruptcy legislation. In *Re Dillard*, 7 Fed. Cases, 3912, citing *Gunn* v. *Barry*, 82 U. S. 610.

While this Honorable Court did not take occasion to pass on the question of uniformity involved in the case of *United States* v. *Constantine, supra,* because it was determined that the so-called excise tax which Constantine had failed to pay was not in truth an excise tax, but a mere penalty. The opinion of the Circuit Court of Appeals in that case indicated that if construed as an excise tax, the Act imposing it would be lacking in the required uniformity, because under its terms it was only to apply in states or municipalities having their own prohibition laws.

In the decision of the cases known as the *Head Money Cases,* 112 U. S. 580, this Honorable Court had occasion to pass on the requirement of uniformity in the constitutional provision relating to the power of Congress to lay and collect duties, imposts and excise taxes. While the Court in that case held that a tax imposed upon the owners of vessels bringing passengers from foreign ports into a port of the United States, met the requirement of uniformity, it was pointed out that this was so because the tax "*operates precisely alike in every port* of the United States where such passengers can be landed." The Court further said:

> "The tax is uniform when it operates with the same force and effect in every place *where the subject of it is found.*"

Obviously the Municipal Bankruptcy Act does not apply in every State of the Union which has political subdivisions that could invoke the Act, but will only apply in such States as may not object to its application. Furthermore, one District within a State may be permitted by the State

to invoke the Act, and another District may be denied that privilege.

In passing on the constitutionality of the new Frazier-Lemke Act, Judge Atwell of the United States District Court for the Northern District of Texas had occasion to discuss the constitutionality of the following section of that Act:

> "This title is hereby declared to be an emergency measure, and if in the judgment of the court such emergency ceases to exist in its locality, then the court in its discretion, may shorten the stay of proceedings herein provided for and proceed to liquidate the estate. (Paragraph 6, 11 U. S. C. A., Sec. 203 S (6))."

In the case under consideration styled *In re Slaughter*, 12 Fed. Supp. 206, Judge Atwell said, of this section:

> "It clearly lacks that territorial uniformity which every national law must have. There is no legal way to have a statute applicable in Kaufman county and inapplicable in Potter county, *or alive in Texas and dead in the Dakotas.* The law must be universal, in so far as it reaches or touches the geography of the nation, and likewise it must be uniform in its application to a given class."

Judge Kennnerly of the United States District Court for the Southern District of Texas in passing on the constitutionality of the new Frazier-Lemke Act concluded that the amended act did not obviate the objection to its constitutionality pointed out in the *Radford* case, and, therefore, that it was unnecessary to rule upon whether the foregoing clause of that Act met the uniformity requirement. (*In re Tschoepe*, decided February 1, 1936.)

(That Act has also been held unconstitutional by the two judges of the United States District Court for the Southern District of Illinois in a joint opinion. (*In re Young*, 12 Fed. Supp. 30.)

In the case of *Florida* v. *Mellon*, 273 U. S. 12, this Honorable Court had before it for consideration the constitutionality of the Federal Estate Tax Act, authorizing a credit on such estate taxes of any inheritance tax paid by a decedent's estate under a state law. In that case the State of Florida contended that the Federal Act was not uniform in its application because Florida could not under the State Constitution adopt any inheritance tax law. The Court in holding that this situation did not impair the uniformity of the Federal Act, said:

> "The contention that the Federal tax is not uniform because other States impose inheritance taxes while Florida does not, is without merit. Congress cannot accommodate its legislation to the conflicting or dissimilar laws of the several States nor control the diverse conditions to be found in the various States which necessarily work unlike results from the enforcement of the same tax. All that the Constitution (Art. I, Sec. 8, cl. 1) requires is that the law shall be uniform in the sense that by its provisions *the rule of liability shall be the same in all parts of the United States.*"

Obviously if the Federal Act under consideration in that case had held that it should apply only to States that would permit its application, the Act would not meet the requirement "the rule of liability shall be the same in all parts of the United States." Yet the Municipal Bankruptcy Act attempts to make its application dependent, not upon the will of Congress, but upon the will of the State legislatures.

POINT D.

State Legislation, Giving Consent to the Application of the Municipal Bankruptcy Act, Would Impair the Obligation of Contracts Contrary to Section X of Article I of the Federal Constitution and Section XVI of Article I of the Texas Constitution.

Special Assistant Attorney General Weston prepared an opinion which was transmitted by the Attorney General to the House Judiciary Committee, when the Municipal Bankruptcy Act was under consideration there. We take the liberty of quoting two sentences from that opinion:

> "The Constitution probably authorizes Congress to enact a bankruptcy law which permits insolvent municipal corporations to effect a composition of their debts through the medium of a Federal Bankruptcy Court, provided the law does not allow the court to interfere with their governmental functions and *provided State law authorizes the municipal corporation to take such action.* * * * But in my opinion it is beyond the power of Congress, *even with State consent,* to enact any bankruptcy law which is applicable to the States themselves or to political subdivisions which are merely departments or branches of the State Government."

We contend that under the authorities heretofore cited the District involved in this case is a mere arm of the State and cannot be subjected to Federal control through bankruptcy legislation or otherwise. However, if it be considered that this is the type of District which State legislation could authorize to invoke the Municipal Bankruptcy Act, and such legislation is necessary to bring about that result, then such State legislation in this instance necessarily brings about an impairment of the obligations held by

your petitioners and, therefore, violates both the Federal and State Constitutions.

The fact that Federal legislation, in the form of the Municipal Bankruptcy Act, supplements the State Act (or is supplemented by the State Act) is immaterial from this standpoint. Subdivision 1 of Section X of Article I of the Federal Constitution does not, like subdivisions 2 and 3 of Section X, provide that a State may pass the prohibited laws *with the consent of Congress.* It prohibits *without qualification* the passage by any State of a law impairing the obligation of contracts, whereas subdivisions 2 and 3 merely prohibit the passage of certain other types of laws "without the consent of the Congress."

Special Assistant Attorney General Weston emphasized the importance of language of this nature in constitutional provisions when he said:

> "It follows that, if the Constitution does not confer this power upon Congress, its lack of authority cannot be supplied by acquiescence of the State. The situation is entirely different where the Constitution itself provides that Congress can act only with State consent, or that the States can act only if Congress consents. (See Article I, Section X, Clauses 2 and 3; Article IV, Section III, Clause 1.)"

Of course, the opinion from which the foregoing quotation is taken, related to the application of the Bankruptcy Act. It expressly classes water districts as among those instrumentalities of the State which cannot be thrown into bankruptcy even with State consent.

The case of *In re Dillard, supra,* establishes that a Federal Bankruptcy Act cannot validate impairment of obligations by State legislation.

In re Rahrer, 140 U. S. 545, involved an Act of Congress which provided that intoxicating liquors transported into a State, should upon arrival in such State, be subject to

operation of the State laws, to the same extent as though such liquors had been produced in the State. This Honorable Court held that a statute of the State of Kansas could apply to prohibit the sale of such liquors in the original packages in view of the Federal statutes. In so holding, the Court pointed out that the State statute was one which it was competent for the State legislature to pass, but which could not operate upon the articles in question until the passage of the Act of Congress; that Congress did not use *terms of permission to the State to act*, but simply removed an impediment to the enforcement of the State laws; that in so doing Congress had not attempted to delegate the power to regulate commerce, or to exercise any power reserved to the States, or to grant a power not possessed by the States, or to adopt State laws.

The Court further said:

> "It does not admit of argument that Congress can neither delegate its own powers nor enlarge those of a State."

The Court pointed out the distinction under Section X of Article I of the Constitution, between the powers enumerated, which the States are forbidden to exercise in any event and those powers covered by Clauses 2 and 3, which may be exercised "with the consent of Congress". Obviously, no State can pass laws having the effect of impairing the obligation of contracts, either with or without the consent of Congress, and obviously Congress cannot delegate to the State its power to enact bankruptcy legislation which must be uniform throughout the United States.

As said in *International Shoe Company* v. *Pinkus, supra*, "states may not pass or enforce laws to interfere with or complement the bankruptcy act, or to provide additional or auxiliary regulations".

A State insolvency law cannot impair the obligations of debtors contracted before the enactment of the law. *Sturges v. Crowninshield*, 12 Wheat. 257. See also *Von Hoffman* v. *City of Quincy, supra.*

Section XVI of Article I of the Constitution of the State of Texas, provides:

> "No bill of attainder, *ex post facto* law, retroactive law, or any law impairing the obligation of contracts, shall be made."

The Legislature of the State of Texas in 1935 passed a statute seeking to specifically authorize political subdivisions of the State to take advantage of the Municipal Bankruptcy Act (Chapter 107, 44th Legislature, Regular Session; Article 1024A, Vernon's Anno. Civil Statutes, 1935). This Act is set out in the appendix to this brief. It specifically deals with "all municipalities, political subdivisions and taxing districts in this State which have power to incur indebtedness"; and authorizes them "to adopt all proceedings and do any and all acts necessary or convenient to fully avail such municipality, political subdivision and taxing district of the provisions of such acts of Congress."

The Supreme Court of Texas had occasion to apply this section of the Constitution in connection with certain moratorium statutes that had been passed by the Texas Legislature, in the case of *Travelers Insurance Company* v. *Marshall*, 124 Texas 45. This decision was rendered after the decision of the Supreme Court of the United States in *Home Building & Loan Association* v. *Blaisdell* (290 U. S. 398). Chief Justice Cureton of the Supreme Court of Texas held the Texas statute unconstitutional, saying that even if the *Blaisdell* case should be interpreted as holding that the Federal Constitution "contains no express limitations on the police powers of the states as such", the State

Constitution plainly subordinates the police powers to the express provision of the Constitution against impairment of contractual obligations. We quote the following from that opinion:

> "The Court cannot be authorized to make a contract for the parties, and its attempt to do so necessarily impairs the original obligation, in view of the authorities. The right to enter into lawful contracts is one of the guaranties of the Texas Constitution. This guaranty is one of the essential liberties of the citizen, and cannot be nullified by legislative enactment empowering courts to substantially rewrite his agreements. 9 Texas Jurisprudence, p. 522, Sec. 90, p. 543, Sec. 108."

See also *Cattle Raisers Loan Co.* v. *Doan,* 86 S. W. (2d) 252, approved by the Supreme Court of Texas in 86 S. W. (2d) 1082.

In the case of *Pryor et al., Commissioners of Sabougla Drainage District* v. *Goza,* 159 Southern 99, the Supreme Court of Mississippi held unconstitutional a State statute which sought to authorize the readjustment of indebtedness of such political subdivisions in the case of insolvency. The court held that such a statute would impair the obligation of the contract evidenced by the bonds issued by the District, and said:

> "The contract clause of the Federal Constitution applies, not only to state action impairing the obligation of contracts of persons, partnerships, and corporations engaged in private business, but to contracts by the state itself and all of its political subdivisions, including counties, municipalities, and other taxing districts."

The court held that it was unnecessary for it to pass on the constitutionality of the Federal Act known as the Mu-

nicipal Bankruptcy Act, because that Act had not been invoked by the District.

The bankruptcy powers of the Federal Government are, of course, subject to the Fifth Amendment to the Constitution of the United States, and we now pass to a consideration of Point E, dealing with the application of that amendment to the Municipal Bankruptcy Act.

POINT E.

The Municipal Bankruptcy Act Violates the Fifth Amendment to the Federal Constitution.

As stated in the opinion of the District Judge, and unchallenged in the opinion of the Circuit Court of Appeals:

> "The bonds are contracts, constitutionally and statutorily executed by the State of Texas, through petitioner, its local agency, secured by taxes levied against property in the District, which taxes are secured by lien against such property. Article 7622 to 7807, inclusive, Texas Revised Civil Statutes."

The State Constitution provides that such a District shall "levy and collect such taxes to pay the interest thereon and to provide a sinking fund for the redemption thereof, as the Legislature may authorize, and in such manner as it may authorize the same" (Section 52, Article III). The Constitution also provides that the annual assessment made upon land and property shall be a special lien thereon. Section 15, Article VIII. Texas Statutes Articles 7712 and 7675 provide for the levy of such taxes and that they shall constitute a lien on the property.

Bondholders are entitled to compel the levy and collection of taxes and the enforcement of tax liens by sale if necessary, in order to protect their rights as bondholders. *Voorhies* v. *City of Houston*, 70 Texas 331; *Hidalgo County et al.* v. *Morey*, 74 F. (2d) 101.

Persons cannot be deprived of their property rights without due process of law, even through the exercise of the powers of bankruptcy conferred on the Federal Government. *Louisville Joint Stock Land Bank* v. *Radford, supra.*

The bondholders in the case at bar are entitled to invoke the Fifth Amendment, because an interference with the taxing power of the District or a discharge of the obligation of the District to levy and collect taxes to pay the bonds would deprive the bondholders of a part of their security. *Rorick* v. *Commissioners of Everglades Drainage District*, 57 F. (2d) 1048; *Los Angeles County* v. *Rockhold*, 44 Pac. (2d) 340. (See also *Von Hoffman* v. *City of Quincy, supra.*)

In the *Louisville Joint Stock Land Bank* case, *supra*, the Court held that the Frazier-Lemke Bankruptcy Act was unconstitutional because it deprived the Bank of the following property rights recognized by the law of Kentucky:

(1) The right to retain the lien,

(2) The right to realize upon the security,

(3) The right to determine when a sale should be held,

(4) The right to protect its interest in the property by bidding at such sale.

These four grounds are all applicable here as follows:

(1) The bondholders have the right to insist on the levy and assessment of taxes secured by lien on the property within the District.

(2) The bondholders have the right to insist on the collection of the taxes, or foreclosure of the lien.

(3) The right exists in the bondholders to have sales of the security made as often as the taxes became delinquent and remain unpaid.

(4) The right exists in the bondholders to protect their interests by purchasing the property covered by the tax lien.

While it is true that these bondholders are only owners of part of the bonds, and that a major portion of the bonds, in amount, is held by other bondholders, nevertheless this proceeding was instituted under a law which only required 30% of the bondholders to agree to the filing of the petition, and under a law which provides that interlocutory orders may issue to put the plan of readjustment into temporary effect without the concurrence of a majority. True, the law requires that 66⅔% of the bondholders in amount, approve the plan before it can be finally confirmed, but their consent can be virtually forced by the filing of the petition by a minority of 30%.

Until the amendments to the Bankruptcy Act passed in 1933 and 1934 the principle applicable to compositions in bankruptcy had never been extended to the interests of secured creditors in their security. It was injected in the amendments dealing with (1) individual debtors, (2) agricultural compositions, (3) railroads engaged in interstate commerce, (4) corporate reorganizations, and (5) the Municipal Bankruptcy Act.

The case of *Continental Illinois National Bank & Trust Company* v. *Chicago, Rock Island, Pacific Railway,* 294 U. S. 648, brought under the Railroad Bankruptcy Act, upheld the constitutionality of that Act in so far as it was then before the Court. However, the opinion in the later case of *Louisville Joint Stock Land Bank, supra,* referred to the railroad case as one wherein "the District Court was held to have the power to enjoin temporarily the sale

of pledged securities", and quoted therefrom as follows:

> "The injunction here in no way impairs the lein, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action."

In the *Railroad* case this Honorable Court pointed out that before the acceptance of any plan—

> "The Interstate Commerce Commission is directed to hold a public hearing, following which it shall render a report recommending a plan which 'will, in its opinion be equitable, will not discriminate unfairly in favor of any class of creditors or stockholders, will be financially advisable * * * and will be compatible with the public interest.' "

It was further pointed out in that case that the debtor contended that the value of the collateral securing the notes was substantially in excess of the loan; that a forced sale of the collateral might result in a substantial deficiency judgment.

No provision is made in the Municipal Bankruptcy Act for any type of hearing before the plan is put into temporary effect, unless 5% of the bondholders, in amount, consolidate for the purpose of launching a contest of the plan. A small bondholder is, therefore, without any relief except on final hearing on the question of the proposed confirmation of the plan, and only then by intervention under court direction.

The hearing provided for before the Interstate Commerce Commission, under the Railroad Act, at least insures some consideration of the plan before it is launched, whereas under the Municipal Bankruptcy Act the agency of the State wherein the political subdivision lies may approve the filing of the petition in bankruptcy without

affording the bondholder any type of hearing. The Federal Act prescribes no hearing before any such agency as may be set up by the State, and none is prescribed by the State Act.

The Railroad Act expressly provides that the plan must furnish "adequate protection for the realization by them (the creditors) of the value of their securities, liens and claims."

Mr. Honnold in his work entitled "Supreme Court Law," makes the following statement under the heading of "Due Process," Vol. II, page 840:

> "The due process clause requires that State action shall be consistent with the fundamental principles of liberty and justice. It requires notice and opportunity to be heard, but not always proceedings in court or the privilege of an appellate review."

It is not contended by the District in this case that these bondholders are creditors of a class not to be affected by the plan of readjustment, nor is it alleged that a majority of the creditors desired the institution of this proceeding to force the acceptance of the plan of readjustment of the bonds, upon the dissenting bondholders. The petition merely alleges that more than 30% of the bondholders have accepted the plan and that it will be able to secure an approval of more than 66⅔% at the time that the plan comes up for confirmation (R. 10 and 11). It further alleges that the plan, dependent upon the securing of a loan from the Reconstruction Finance Corporation, would enable the District to refund the bonds of said District at 49.8% on the dollar "which said authorization would enable your petitioner to reduce its bond taxes at least two-thirds and would make the District financially sound" (R. 6).

The Municipal Bankruptcy Act provides that it "shall apply as fully to taxing districts and their creditors, whose

interest or debts have been acquired or incurred prior to such date, as to taxing districts and their creditors, whose interest or debts are acquired or incurred after such date." (Section 80 (j)). It further specifies that a plan of readjustments "shall include provisions modifying or altering the right of creditors generally, or any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise." (Section 80 (b)). It further provides that acceptance of the plan by a majority of any class of creditors is unnecessary "if provision is made in the plan for the protection of the interests, claims, or liens of such creditor, or class of creditors." (Section 80(d). last clause).

In Re Tennessee Publishing Company, a case decided by the Sixth Circuit Court of Appeals on February 13, 1936, involved a similar provision of Section 77(b) of the Bankruptcy Act, relating to corporate reorganizations. That court held unconstitutional a provision of that Act, relating to the putting into effect of a plan of reorganization, without the consent of a majority of a class of creditors affected thereby. Subsection (b)5(d) of that Act provides for the protection of the lien of nonassenting creditors "by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection." It will be noted that this clause is quite similar to the last clause of Section 80(d) of the Municipal Bankruptcy Act quoted above.

The Sixth Circuit Court of Appeals held that a plan tendered under Subsection (b)5 of the Act, authorizing corporate reorganization, violated the due process clause of the Federal Constitution, and cited as authority the case of *Louisville Bank* v. *Radford, supra.* It also distinguished

the case of *Continental Bank* v. *Rock Island Railway, supra,* by saying:

> "That case, however, goes no further in its consideration of the due process clause of the Fifth Amendment, than to hold the statutory provision permitting delay in the enforcement of contracts affect only the remedy, and deals with a statute which does not permit adjustment of liens without lienholders' consent."

POINT F.

The Petition Revealed that the Plan of Readjustment was Dependent Upon a Loan to the District by the Reconstruction Finance Corporation Under Conditions, Imposed by Section 36 of the Agricultural Adjustment Act, and by the Loan Contract, Which Invaded the Exercise of Governmental Powers of the District.

The petition alleges that the Reconstruction Finance Corporation will enable the District to carry out the plan of readjustment by making a loan to it of $400,000 "for the purpose of refunding the bonds of said District at 49.8¢ on the dollar" (Record page 6). It further reflects the various conditions which the Reconstruction Finance Corporation will impose in making the loan. (See loan agreement as alleged, Record page 13 *et seq.*) Section 36 of the Agricultural Adjustment Act (48 Statutes, page 49, as amended; Section 403 of Title 43, U. S. C. A.) authorizes the Reconstruction Finance Corporation to make loans to such Districts upon certain conditions, including the following:

> "3. The borrower shall agree not to issue during the term of the loan any other bonds so secured except with the consent of the corporation. * * *
>
> "5. In the case of a loan to reduce or refinance its outstanding indebtedness the borrower shall agree, to

the satisfaction of the corporation, to reduce, in so far as it lawfully may, the annual taxes, assessments, and other charges imposed by it for or on account of the project by an amount proportional to the reduction in the corresponding annual requirements for the principal and interest of its outstanding indebtedness by reason of the operation of this section."

Part 4 of the Act is entitled "Refinancing of Agricultural Improvement District Indebtedness for the Benefit of Farmers; Loans by Reconstruction Finance Corporation." Under this Act no loan will be made unless "a substantial reduction will be brought about in the amount of the outstanding indebtedness of the applicant."

The conditions imposed in connection with the making of the loan, as alleged in the plaintiff's petition, embrace many features that give the Reconstruction Finance Corporation control over the political subdivision. Those conditions were set forth in the resolution adopted by the Reconstruction Finance Corporation and approved by the District (R. 12 to 28, inclusive).

The terms and conditions were numbered in the resolution, and we refer to some of them by number as follows:

1. All loans shall be disbursed within such time as may be fixed by the "chief or acting chief of the Drainage, Levee, and Irrigation Division (hereinafter referred to as the Division Chief)."

5(b). The Division Chief may make the loan directly to consenting owners of bonds (without their incurring any individual liability thereon) in the event that the Division Chief wishes to "keep any or all of the deposited securities (of the District) alive for a greater or lesser length of time in order to maintain a parity of rights." Under such circumstances the deposited bonds are to be considered as outstanding obligations of the District, and though the

District is not a party to the loan, it is to pay the interest thereon.

8(a). The District is not to issue any other bonds having similar security to the new bonds or the old securities pledged to the Reconstruction Finance Corporation, "except with the consent of this Corporation"; and the District will pay to the Corporation the amount by which its collections exceed its current obligations and will reduce its annual taxes proportional to the reduction in the corresponding annual requirements for principal and interest of its outstanding indebtedness.

8(b). The District will not incur any indebtedness unless it can pay cash therefor from normal revenue and "will not issue any tax anticipation warrants, notes or other obligations, of any kind without first securing the written consent of this Corporation."

8(c). The District will give the Corporation notice of any meeting of its governing body and the Corporation "shall have the right to have such meetings attended by any authorized representative."

8(j). The District will at all times give the Corporation "full access to and copies of all records, reports and files of the District, and its governing authority."

9. Other conditions precedent to the making of the loan are that the District shall have complied with the requirements of the Division Chief as to reassessment of the benefits upon the lands within the District, and as to *adjustment or collection of taxes,* or assessments that are now delinquent; and the District shall also comply with any requirements of the Division Chief regarding the *exclusion of lands from the District which he deems unproductive,* or for other reasons considers should not be included in the District.

The resolution of the District shows that it "assents and agrees to all the terms and conditions" (R. 27 and 28).

Obviously the foregoing conditions attach to the making of the loan and give the Federal Agency control over the State Agency in many respects which are incompatible with State sovereignty. Furthermore, they call for delegation of powers by the political subdivision of the State which have been delegated to it by the State, but which in turn cannot be delegated by it to another agency. See *Bowers v. City of Taylor et al.*, 16 S. W. (2d) 520 (24 S. W. (2d) 816 on rehearing), a decision by the Commission of Appeals of Texas, adopted by the Supreme Court of Texas. We quote from that case in 16 S. W. (2d), as follows:

> "The principle is well settled that a city cannot by contract or otherwise surrender its governmental or legislative functions, nor can it legally enter into any contract which will embarrass or control its legislative powers and duties or which amount to an abdication of its governmental function or of its police power."

This rule of law was recognized in the case of *Arkansas-Missouri Power Co. v. City of Kennett*, 78 F. (2d) 911. That case involved a controversy as to the power of the Federal Emergency Administration of Public Works to make a loan to a municipality in the State of Missouri. The Court held that the contract regarding the loan imposed certain conditions of a nature similar to those in the case at bar, which called for a delegation of the powers of the municipality to the Federal Agency, and held that such a contract was, therefore, unlawful.

There is no question about the right of your petitioners in the case at bar, to raise by demurrer the point as to the invalidity of the contract governing the loan to be made by the Reconstruction Finance Corporation to the District. Obviously, the question here is not one of a tax or burden that falls upon your petitioner because of the invalidity of

the contract; instead the question arises on the face of the petition and the plan of readjustment tendered by the District, because no plan can be confirmed by the Court unless it affirmatively appears that the District is authorized by law "to take all action necessary to carry out the plan". The showing must be made by the District, and if the petition reveals that the showing cannot be made the proceeding must collapse.

In this connection, we point out that the Reconstruction Finance Corporation is disbursing Federal funds and that those funds can only be used to provide for the general welfare of the United States. In declaring the Agricultural Adjustment Act unconstitutional because of the regulatory features involved in *United States* v. *Butler, supra*, this Honorable Court said:

> "We are not now required to ascertain the scope of the phrase 'general welfare of the United States' or to determine whether an appropriation in aid of agriculture falls within it."

We submit that even if an appropriation in aid of agriculture might fall within the clause of the Constitution allowing the Federal Government to lay and collect taxes for the general welfare of the United States, it is going too far to contend that Federal funds may be advanced to local agricultural improvement districts, such as the one involved in this case, merely because of the claimed effect it might have "for the benefit of farmers". See *Missouri Public Service Company* v. *City of Concordia*, 8 Fed. Supp. 1, holding that loans by Public Works Administrator cannot be made for municipal projects, having no relation to interstate commerce.

Conclusion.

In conclusion we submit that this case is one calling for the exercise by this Court of its supervisory powers in

order that your petitioners may not be deprived of rights granted to them under the Federal Constitution and the State Constitution. The question involved is one which is of importance throughout the United States; and in the Fifth Circuit where this case arose there are two other States which have statutes similar to the Texas statutes (to-wit: the States of Florida and Louisiana) permitting their political subdivisions to invoke the Municipal Bankruptcy Act.

It is respectfully prayed that this Honorable Court grant a writ of certiorari and reverse the decree of the United States Circuit Court of Appeals, and affirm the decree of the United States District Court.

Respectfully submitted,

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